IN THE

Supreme Court of the United States

OCTOBER TERM, 1944.

No. 191

JOHN K. BERETTA, PETITIONER,

versus

COMMISSIONER OF INTERNAL REVENUE,
RESPONDENT.

Petition for Writ of Certiorari

TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT.

L. G. SEELIGSON,
National Bank of Commerce Building,
San Antonio 5, Texas,
Counsel for Petitioner.

SEELIGSON, COX & PATTERSON,
C. W. TRUEHEART,
San Antonio 5, Texas,
Of Counsel.

LODOVIC PRINTING CO., SAN ANTONIO, TEXAS

SUBJECT INDEX.

LIST OF AUTHORITIES.

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TO THE HONORABLE THE SUPREME COURT OF THE UNITED STATES:

Petitioner, John K. Beretta, respectfully shows:

I.

SUMMARY STATEMENT OF THE MATTERS INVOLVED.

Petitioner seeks a review of a judgment of the United States Circuit Court of Appeals for the Fifth Circuit, af-

firming a decision of the Tax Court, which redetermined a deficiency of income tax for the year 1937, imposed by the Commissioner of Internal Revenue, in the amount of $3892.40.

The sole matter at issue is whether certain money received by the Petitioner as a corporate stockholder was in partial liquidation of the corporation, so as not to be taxable to him as ordinary income.

The facts are wholly undisputed, the Findings of Fact of the Tax Court (R. 19-27) being based upon a Stipulation of Facts (R. 52-81).

The facts are stated fairly accurately, and with several exceptions completely, in the Opinion of the Court below, 141 F. (2d) 452. (R. 87). We state them somewhat more briefly.

The taxpayer was a stockholder in the Laredo Bridge Company, a Texas corporation, owning and operating a toll bridge across the Rio Grande River between Laredo, Texas, and Nuevo Laredo, Mexico, and this bridge constituted the principal asset of the corporation (R. 19-21, 52-3).

On June 6, 1937, the concession by the Mexican Government under which this bridge had been constructed expired, and Mexico took over that end of the bridge, at two-thirds of its appraised value, in accordance with the terms of the concession. On July 24, 1937, Mexico paid the Bridge Company $75,962.28 therefor (R. 22, 53-7). This sale decreased the earnings of the Company by about 40% (R. 73).

On September 14, 1937, the corporate directors, after ascertaining as against an investment cost of $206,536.90 (R. 60) a net capital loss of $68,630.53 on the enforced sale of the Mexican end of the bridge, voted to distribute to the stockholders the sum of $135,000.00. This represented the net sum ($75,877.48) received from the sale to Mexico and most of the sum of $62,029.89 reserved for depreciation

of the Mexican end of the bridge (R. 23-4, 58-62). On October 12, 1937, the stockholders approved this action and formally resolved a decrease of capital stock from $500,000.00 to $250,000.00; appropriate charter amendment being approved by the Secretary of the State of Texas on October 23, 1937 (R. 24-5, 62-66).

At the time of these transactions there was no intention or purpose to completely liquidate, terminate or dissolve the corporation.

This reduction of capital stock was accomplished by reducing the par value of the shares from $100.00 to $50.00 per share, each certificate being endorsed:

> "Authorized capital stock decreased from $500,000.00 to $250,000.00 in accordance with resolution of stockholders at meeting held October 12, 1937, par value each share reduced from $100.00 to $50.00." (R. 26, 66).

Then the endorsed certificates were returned to the stockholders, and the $135,000.00 was distributed to them in the latter part of 1937 (R. 26, 66, 76-7).

The Petitioner and wife, during 1937, received $23,706.00 of the $135,000.00 distribution, but reported none of this amount as taxable income in their income tax returns for that year (R. 26, 66).

Petitioner has contended throughout that the $135,000.00, out of which he received his part as a stockholder, was a distribution of capital in partial liquidation of the corporation and should be treated as in part payment for the one-half of the stock that was cancelled and redeemed, when substantially one-half of the capital assets (the Mexican end of the bridge) was sold by the corporation.

The Commissioner has conceded that if there was a partial liquidation of the Company, as defined by Section

115(i), then this distribution was not a taxable dividend to the stockholders (R. 29).

Both Courts below held that this distribution was a taxable dividend, but the Circuit Court of Appeals has somewhat confused the issue, as later shown (post, pp. 5-6), in the latter part of its opinion, by a clear misinterpretation of the Tax Court's opinion as to this being a dividend out of earnings and profits under Section 115(g).

Section 115 of the Revenue Act of 1936, in the portions here applicable, is set out in the appendix hereto.

II.

JURISDICTION.

1. The jurisdiction of this Court is invoked under the provisions of U. S. C. A., Title 28, Chapter 9, Section 347(a).

2. The date of the decision of the Circuit Court of Appeals sought to be reviewed is March 3, 1944 (R. 87). A petition for rehearing was timely filed on March 21, 1944 (R. 95), which was considered and overruled without additional opinion on March 25, 1944 (R. 101).

3. The one question here presented was duly raised by the Petitioner in the Tax Court (R. 3-4). After its determination by the Tax Court (R. 27), with dissent (R. 41), against Petitioner (R. 37-8), Petitioner filed his petition for review by the United States Circuit Court of Appeals for the Fifth Circuit (R. 42), assigning as error the holding of the Tax Court, in its various aspects, that there was no partial liquidation of the Laredo Bridge Company in 1937 (R. 47-9).

4. In the Tax Court, the case was consolidated with its companion case of *Sallie Ward Beretta vs. Commissioner*

of Internal Revenue (R. 52), she being the wife of the Petitioner herein, but the Circuit Court of Appeals, upon granting the petition for review, directed that only the record in this cause be printed, and that further proceedings in the wife's cause should be suspended to abide the final result of this cause. (R. 82-3).

5. The Circuit Court of Appeals, again with dissent (R. 93), held that there was not a distribution in partial liquidation of the corporation (R. 87), and Petitioner in his petition for rehearing therein complained of the error of the Circuit Court of Appeals in that regard. (R. 95).

III.

QUESTION PRESENTED.

The sole question for decision here is whether the $135,000.00 distribution by the Company was a capital distribution "in partial liquidation" of the corporation, as being "in complete cancellation or redemption of a part of its stock" (Sec. 115 (i)), so as to be "treated as in part payment in exchange for the stock" under Section 115(c) of the Revenue Act of 1936.

Petitioner contended for an affirmative answer to this question, but in addition urged several other contentions, which he now directly abandons.

Respondent contended simply for a negative answer to the question above stated, but in addition he made a counter-contention to one of Petitioner's abandoned contentions, which counter-contention the Circuit Court of Appeals has apparently misinterpreted as an original contention by the Commissioner (R. 90), for in the last three paragraphs of its Opinion (R. 92-3) that Court decides such supposed contention upon the erroneous theory that it in itself is determinative of the case.

Thus, the Circuit Court of Appeals says that the Commissioner contended that the $135,000.00 distribution was a dividend out of earnings and profits, and the decisions cited by the Court as supporting this base such holding on a construction of Section 115(h) of the Revenue Act. The opinion of the Tax Court, however, clarifies the confusion about the contentions made, in this manner:

> "We interpret his (the Commissioner's) brief to concede that if there was a partial liquidation of the company as defined by Section 115(i), then the $135,000.00, which the company distributed in 1937 in alleged partial liquidation, was not a taxable dividend to the stockholders. In other words, we interpret the Commissioner's present position *to rest squarely upon the proposition that there was no partial liquidation of the company* in 1937; that, there being none, there were taxable dividends under Section 115(a) and (b), provided there were sufficient accumulated earnings of the corporation after February 28, 1913, or earnings and profits of the taxable year, with which to pay the dividends." (R. 29).

The Tax Court then, after deciding that there was no partial liquidation of the company under Section 115(i), proceeds to dispose of Petitioner's alternative contention as above stated, holding on this and another abandoned contention against the Petitioner (R. 30-40), but leaving the primary issue of no partial liquidation under Section 115(i), as here now presented, completely determinative of the case if such issue had been determined in favor of the Petitioner.

Thus, as fully determinative of this case, we have here presented, as the sole question for decision, whether the $135,000.00 distribution by the company was a partial liquidation of that company under the precise terms of the definition of Section 115(i) of the 1936 Revenue Act.

This question, in turn, involves two points:

First, whether, as wrongly held by the Circuit Court of Appeals, an intention and purpose to completely liquidate, terminate and dissolve the corporation is essential to any partial liquidation; and,

Second, whether a reduction in the par value of corporate stock can be a complete cancellation or redemption of a part of such stock.

IV.

REASONS RELIED UPON FOR ALLOWANCE OF THE WRIT.

1. The Circuit Court of Appeals has here rendered a decision on the first point above stated (that partial liquidation must be a step in complete liquidation) in direct conflict with the decisions of the same and other Circuit Courts of Appeals on the same matter, in the following cases:

Commissioner vs. Quackenbos, 78 F. (2d) 156 (2d Cir.);

Commissioner vs. Cordingley, 78 F. (2d) 118 (1st Cir.);

Malone vs. Commissioner, 128 F. (2d) 967 (5th Cir.);

Kelly vs. Commissioner, 97 F. (2d) 915 (2d Cir.).

2. The Circuit Court of Appeals has here rendered a decision on the second point above stated (that reduction in par value of stock is not a complete cancellation or a redemption of a part of such stock) in direct conflict with the decisions of the same and other Circuit Courts of Appeals on the same matter, as follows:

Commissioner vs. Straub, 76 F. (2d) 388 (3rd Cir.);
Bynum vs. Commissioner, 113 F. (2d) 1 (5th Cir.);
Malone vs. Commissioner, 128 F. (2d) 967 (5th Cir.);
Patty vs. Helvering, 98 F. (2d) 717 (2d Cir.).

3. On the decision of both of these points, as well as on the ultimate question of no partial liquidation, by the Circuit Court of Appeals, there is recorded a dissent by Circuit Judge Sibley (R. 95). In addition, on the same points and questions, with written opinion, there is a dissent in the Tax Court by Presiding Judge Murdock, who says in part:

> "The word 'stock', as used in the statute, does not mean stock certificates, but even if it did, the stock certificates are completely cancelled in part, that is, to the extent of one-half, where the par value is reduced 50%." (R. 41).

4. The opinion of the Circuit Court of Appeals herein does not discuss or distinguish any of the above cited conflicting decisions, although all of them were pressed upon the attention of the Court in Brief for Appellant.

5. The Circuit Court of Appeals has herein, on the two points and one question above shown, rendered a decision on an important matter of Federal law, which has not been, but definitely should be, settled by this Court, out of regard for the taxpayers of this country, to-wit: construing Section 115 and subdivisions (c) and (i) thereof of the Revenue Act of 1936.

6. Section 115 of the Revenue Act of 1942 is in the particulars here involved substantially identical with Section 115 in the Revenue Act of 1936. Therefore, it is the

more important to the public interest that the conflict of decisions in this matter be resolved and the true construction of the income tax law presented in this case, as being typical of the same problems now presented to taxpayers under the 1942 Revenue Act, be settled once and for all by this, the highest Court in the land.

7. In this connection, the 1943 and 1944 Revenue Acts make no change in Section 115 or any other provisions affecting the matter here at issue.

WHEREFORE, Petitioner prays that Writ of Certiorari issue under the seal of this Court, directed to the United States Circuit Court of Appeals for the Fifth Circuit, sitting at New Orleans, Louisiana, commanding said Court to certify and send to this Court a full and complete transcript of the record and the proceedings of said Court had in the case numbered and entitled on its docket as No. 10,-621, *John K. Beretta, Appellant, vs. Commissioner of Internal Revenue, Appellee*, to the end that this cause may be reviewed and determined by this Honorable Court, as provided by the statutes of the United States, and that the judgments herein of both Courts below be reversed by this Court, with direction to the Tax Court that judgment therein be entered in favor of the Petitioner; and for such relief as to this Court may seem proper.

Dated June 20th, 1944.

L. G. SEELIGSON,
National Bank of Commerce Building,
San Antonio 5, Texas,
Counsel for Petitioner.

SEELIGSON, COX & PATTERSON,
C. W. TRUEHEART,
San Antonio 5, Texas,
Of Counsel.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

I.

OPINIONS OF THE COURTS BELOW.

The opinion of the Tax Court is reported in 1 T. C. 86, (R. 27). Its decision is found on R. 41.

The opinion of the Circuit Court of Appeals for the Fifth Circuit is reported in 141 F. (2d) 452 and is found on R. 87. The judgment of that Court is found on R. 94.

No opinion was written on rehearing, but the order overruling petition for rehearing is found on R. 101.

II.

JURISDICTION.

1. The date of the decision of the Circuit Court of Appeals sought to be reviewed is March 3, 1944 (R. 88). The petition for rehearing was timely filed on March 21, 1944 (R. 97), and it was considered and overruled without additional opinion on March 25, 1944 (R. 103).

2. The jurisdiction of this Court is invoked under the provisions of U. S. C. A., Title 28, Chapter 9, Section 347(a).

3. A more detailed statement with respect to the jurisdiction of this Court is found under corresponding caption in the Petition, pages 4 to 5 hereof, and a Statement of the Reasons Relied on for the Allowance of the Writ is also set forth in the Petition, pages 7 to 9, to both of which reference is here made.

III.

STATEMENT OF THE CASE.

A statement of all matters material to this controversy has been made in the Petition under the caption "SUMMARY STATEMENT OF THE MATTERS INVOLVED", pages 1 to 4, which is here adopted and made a part of this Brief.

IV.

SPECIFICATIONS OF ERROR.

1. The Circuit Court of Appeals erred in holding that the $135,000.00 distribution made by the corporation in 1937 was not a distribution in partial liquidation, and erred in not holding that it was a capital distribution "in partial liquidation of the corporation, being in complete cancellation or redemption of a part of its stock" (Section 115(i)), so as to be "treated as in part payment in exchange for the stock", under Section 115(c) of the Revenue Act of 1936.

2. The Circuit Court of Appeals erred in holding that an intention and purpose to completely liquidate, terminate and dissolve the corporation is essential to any partial liquidation.

3. The Circuit Court of Appeals erred in holding that a reduction in the par value of corporate stock cannot be a complete cancellation or redemption of a part of such stock.

V.

ARGUMENT.

Explanation of the Issue Presented.

An outline summary of the argument can be found in the subject index. The authorities relied upon by Petitioner as supporting his several contentions are cited in the

Petition herein (ante, p. 7), in the first two paragraphs under the caption "Reasons Relied Upon For Allowance of the Writ."

As previously more fully shown (ante, pp. 5-6), Respondent concedes that if there was a partial liquidation in 1937, the distribution by the Laredo Bridge Company of Petitioner's part of the $135,000.00 was not a taxable dividend to Petitioner, as a stockholder (R. 29). If it was in partial liquidation in the sense of Subdivisions (c) and (i) of Section 115, no question ever arises about the application of Subdivisions (g) and (h) of this section. In other words, the amount received by Petitioner out of the $135,000.00 distribution was not taxable as a dividend out of earnings and profits, within Subdivisions (g) and (h), because, as a distribution of capital in partial liquidation, it was not taxable.

This is very well illustrated by the holding in *Patty vs. Helvering*, 98 F. (2d) 717, opinion by Circuit Judge L. Hand, wherein it is said:

> "As there used (meaning in Section 115(g)), 'taxable dividends' include all dividends other than 'liquidating dividends', for all others are taxable in fact, and 'liquidating dividends' alone are not taxable * * *. Therefore we hold that if redeemed shares have been issued bona fide, Section 115(g), 26 U. S. C. A., Section 115(g), never applies." See also *Commissioner vs. Quackenbos*, 78 F. (2d) 156; *Kelly vs. Commissioner*, 97 F. (2d) 915; *Commissioner vs. Cordingley*, 78 F. (2d) 118.

This same distinction is recognized in *Commissioner vs. Brown*, 69 F. (2d) 602, (7th Cir.), where it is said, again referring to the subdivisions of Section 115:

> "Subdivision (g) makes an exception, but does not turn every partial liquidation into a dividend

> whenever there are undistributed earnings in the corporation. On the contrary, in such a case the partial liquidation is to be treated as the equivalent of a dividend only when made under certain specified circumstances. It is the time and manner of the liquidation, not the existence of undistributed earnings, which makes the distinction (distribution) essentially equivalent to a taxable dividend."

We therefore make no question about the correctness of the holding of the Circuit Court of Appeals that this distribution should otherwise be deemed to have been made from the profits of the corporation, rather than its capital or reserves. This could not render this distribution taxable, under the plain showing of the Tax Court's opinion herein (R. 29), provided it was a partial liquidation within the meaning of the law.

Thus, is presented as the only question for determination: Was this distribution in partial liquidation of the corporation under the precise terms of Subdivisions (c) and (i) of Section 115 of the Revenue Act of 1936, the pertinent provisions of which section are shown in the appendix hereto?

This, in turn, resolves itself into the two questions discussed by the Circuit Court of Appeals, to-wit, whether intent and purpose of ultimate complete liquidation are essential to any partial liquidation under the provisions of the law, and whether a reduction in the par value of stock constitutes a complete cancellation or redemption of a part of such stock, under the above provisions.

The Manifest Meaning of Subdivision (i) of Section 115 is that Intent and Purpose of Ultimate Complete Liquidation is not Essential to Every Partial Liquidation.

A mere reading of the definition of *partial liquidation* as given in Subdivision (i) would seem to settle this matter. It provides as follows:

> "As used in this section the term 'amounts distributed in partial liquidation' means a distribution by a corporation in complete cancellation or redemption of a part of its stock, or one of a series of distributions in complete cancellation or redemption of all or a portion of its stock."

The term quoted and defined in this provision refers to the same identical term as used in Subdivision (c) of this section. As stated in the definition, there is included within its meaning both a distribution in complete cancellation or redemption of a part of the stock, as well as *"one of a series"* of such distributions of "all or a portion of its stock."

Thus, by virtue of this definition, the distribution mentioned in Subdivision (c) is a capital distribution (1) whether it is a single one in complete liquidation of all stock, (2) whether it is one of a series in complete liquidation of all stock, (3) whether it is one of a series in complete liquidation of a portion of the stock, or (4) whether such distribution is a single isolated one in complete liquidation, cancellation or redemption of a part of the stock.

Certainly this last class does not contemplate an eventual winding-up or liquidation of the corporation, but merely the complete liquidation of only a part of its stock. On the other hand, class (1) above covers such winding-up and liquidation of the corporation all at once, class (2) such an effectual winding-up by degrees, and class (3) an expected

but abortive winding-up and liquidation of the corporation by degrees. This leaves for class (4)'s coverage only the situation here presented—a single isolated "distribution by a corporation in complete cancellation or redemption of a part of its stock," being the first thing mentioned in the above definition.

To imply an intent and purpose of ultimate complete liquidation of the corporation and all of its stock as an essential incident to this class is to read into the law something that is not remotely implied thereby. Still worse, it amounts to implying something directly contrary to the plain implication in the full text of the law.

Why mention "a distribution by a corporation in complete cancellation or redemption of a part of its stock" as a class in itself, if it must be "one of a series of distributions in complete cancellation or redemption of * * * a portion of its stock"? The idea conveyed by the word "series" is that other later distributions are contemplated at the time of the making of the one in question, which, of course, would be appropriate to the idea of a final complete winding-up of the corporation and cancellation of all of its stock. The absence of any such expression in the definition of the first class mentioned in Subdivision (i) affirmatively excludes the implication of the idea of other later distributions being contemplated at the time of the making of the one in question. Only by such construction can we avoid the result that Congress has in its definition of "partial liquidation" intentionally confused by specifying as a class in itself "a distribution by a corporation in complete cancellation or redemption of a part of its stock", when "partial liquidation", in the sense of the law, could be had only through "one of a series of distributions."

The Decision of the Circuit Court of Appeals Ignores this Manifest Meaning of Subdivision (i).

The opinion of the Circuit Court of Appeals completely ignores the statutory definition of "partial liquidation." It does not even resort to the general definition of that term as given in 31 Words and Phrases, (perm. ed.), 126-7, but instead prefaces its discussion by a citation from that authority's definition of "liquidation." It then declares that there must be an intent and purpose to liquidate and wind-up a corporation, in order for there to be a partial liquidation, citing for this only *Holmby Corporation vs. Commissioner*, 83 F. (2d) 548 (9th Cir.), and *Canal Commercial Trust & Savings Bank vs. Commissioner*, 63 F. (2d) 619 (5th Cir.).

These cases throw no light on the necessity of a partial liquidation being a step in the winding-up of a corporation. In the Holmby case the Board of Tax Appeals found that certain distributions made to stockholders by a corporation that was eventually wound-up were not made "in the ordinary course of business" and that each such distribution was "*one of a series* of distributions in complete cancellation and redemption" of its stock. It was concerning such distributions that the Court said that the determining element was whether they were made "after deciding to quit and with intent to liquidate the business", citing the Canal-Commercial Trust case. The opinion in the latter is by Judge Sibley, who dissented in the case at bar, and the same expression about the determining element concerning a distribution is used. Subdivision (i) is not even involved.

The cases relied upon by Petitioner (ante, p. 7) are completely ignored by the Circuit Court of Appeals.

The Decision of the Tax Court Admits Intent to Completely Liquidate Unessential to Partial Liquidation, if this Present Involved Distribution is in Complete Cancellation of Part of Such Stock.

In contrast to the Circuit Court of Appeals, the Tax Court frankly concedes the force of the authorities relied upon by Petitioner, but undertakes to limit the application of those sustaining the point that intent to completely liquidate is not essential to partial liquidation to instances where there is a complete retirement of some of the shares of stock, rather than a reduction in par value of all the stock, and further to limit the application of those authorities sustaining the point that a reduction in par value of stock is a complete cancellation or redemption of a part of such stock to instances where the distribution in question is one of a series of distributions in complete liquidation of the corporation. As later shown, this is a distinction without a difference. (Post, pp. 27-8). We quote from the Tax Court's opinion:

> "There is no contention by Petitioners in the instant case that the 1937 distribution in question was one of a series of distributions made in the complete and final liquidation of the Laredo Bridge Company * * *. So it cannot be said that in 1937 a complete liquidation of the corporation was under way or that the distribution in question was one of a series of distributions to be made in the complete liquidation of the company. If it could be said that such was the case, then the fact that none of the corporation's shares were cancelled and retired as a result of the distribution would not be material and *the method used of reducing the par value of the stock from $100.00 to $50.00 per share would be sufficient*, and the cases of *Bynum vs. Commissioner*, 113 F. (2d) 1, and *Commissioner vs. Straub*, 76 F.

(2d) 388 (cited in support of Petitioner's second point, but not discussed by the Circuit Court of Appeals), affirming 29 B. T. A. 216 *would be in point* * * *.

"Petitioners argue, however, that *there can be a partial liquidation of a corporation without there being an intent to completely liquidate* the corporation and cease business. *That, of course, is true.* The Court points out that fact in its decision in *Commissioner v. Quackenbos*, 78 Fed. (2d) 156, wherein it is said:

" 'The force of the Commissioner's contention that the distribution was not a partial liquidating dividend such as is governed by section 115(c) because the corporation was not at the time planning a cessation of business or in the process of final liquidation is hard to perceive. When sub-section (c) refers to amounts distributed "in partial liquidation", *it nowhere limits such distributions to payments made in the course of winding-up the corporation.* Moreover, Article 625 of Regulations 74 provides that: "The phrase 'amounts distributed in partial liquidation' means a distribution in complete cancellation or redemption of a part of its stock, or one of a series of distributions in complete cancellation or redemption of all or a portion of its stock." *A redemption of a part of the stock of a corporation,* whether it be of all of a class such as of preferred stock, or of a part of the common stock, *has no necessary relation to the winding-up of the corporation.*'

"So this brings us to the question * * *. Was the distribution in question which the company made in 1937 made in complete cancellation or redemption of a part of its stock?" (R. 31-32).

The *Quackenbos, Cordingley, Kelly* and *Malone* cases all hold intent to completely liquidate not essential.

The *Quackenbos* case and the *Cordingley* case (78 F. (2d) 118, 1st Cir.) grew out of the same identical distribution to the stockholders of the Woonsocket Worsted Mills, which effected a reduction of its capital stock by the purchase by the corporation from its stockholders of about one-third of its stock, having a par value of $100.00, at its then present value of $90.00. Being thus based on the same facts, these two decisions of the first and second Circuits supplement one another, the *Quackenbos* opinion being by Judge Augustus N. Hand and the *Cordingley* by Judge Morton. We quote from the latter:

> "It is clear that the statute contemplates partial liquidation of corporations accompanied by partial retirement of outstanding stock; and that amounts paid for the retired stock are not taxable dividends, except as stated in sub-section (g). *The Commissioner's contention that payments made by a corporation in exchange for its stock are taxable as dividends, except when made in pursuance of a plan for complete liquidation of the corporation, cannot be sustained.* See *Commissioner vs. Brown*, 69 F. (2d) 602, 604 (C. C. A. 7), cert. denied, 293 U. S. 579; *Commissioner vs. Babson*, 70 F. (2d) 304, 7th Cir., cert. denied, 293 U. S. 571."

See also *Kelly vs. Commissioner*, 97 F. (2d) 915 (2d Cir.).

Malone vs. Commissioner, 128 F. (2d) 967, is a decision of the Fifth Circuit, the opinion being written by Judge Sibley, who dissented in the case at bar. Its discussion will be more appropriately had in connection with the second point involved. For present purposes it suffices to quote therefrom as follows:

> "It is conceded that a partial liquidation may occur without an intention to discontinue business. By the definition, it occurs when a part of the corporation's stock is completely cancelled or redeemed.

A Distribution by this Corporation to Reduce the Par Value of Its Stock is One "In Complete Cancellation or Redemption of a part of its Stock", Within Subdivision (i).

The true construction of Subdivision (i) would seem to be that by the word "stock" is meant the intangible interests in the corporation, rather than stock certificates or shares of stock. As very well said by the Supreme Court of Texas in *Yeaman vs. Galveston City Company*, 106 Tex. 389, 167 S. W. 710, 720:

> "In a corporation the certificate of stock is not the stock itself; it is but a muniment of title, and evidence of the ownership of the stock. It is not necessary to a subscriber's complete ownership of the stock."

As before shown, following the involuntary sale to Mexico of the Mexican end of the bridge, the Laredo Bridge Company, on a vote of its stockholders and directors, in the same year as received (1937), distributed to its stockholders the sum of $135,000.00, being the proceeds of this sale, plus a sum reserved for depreciation of the Mexican end of the bridge. On the basis of similar corporate action, the company at the same time decreased its capital stock from $500,000.00 to $250,000.00, there being, however, no intention of going out of business. This unquestioned good faith reduction of capital stock was accomplished by reducing the par value of the shares from $100.00 to $50.00 per share, each certificate of stock being endorsed to show this corporate action.

With reference to the situation thus presented, Presiding Judge Murdock, of the Tax Court, when dissenting in this case, said:

"If a corporation reduces its capital stock by one-half, there is a complete cancellation or redemption of one-half of its stock, regardless of whether one-half of the stock certificates are cancelled or whether the par value of each certificate is cut in two. The statute defines amounts distributed in partial liquidation as a distribution 'in complete cancellation or redemption of a part of its stock.' Speaking of stock in a broader sense than mere certificates, there would be the same cancellation in each case. The word 'stock', as used in the statute, does not mean stock certificates, but even if it did, the stock certificates are completely cancelled in part, that is, to the extent of one-half, where the par value is reduced 50 per cent. Therefore, I dissent from the holding in this case that a reduction in par value, accompanied by a distribution, cannot be a partial liquidation." (R. 41).

The Straub, Bynum, Patty and Malone Cases All Hold that Reduction in Par Value of Stock is a Complete Cancellation or Redemption of a Part of such Stock.

In *Commissioner vs. Straub*, 76 F. (2d) 388 (3rd Cir.), it is said:

"The evidence, in our opinion, establishes that the distribution of 1928 was made in partial liquidation of the corporation's capital stock. This is true notwithstanding the fact that *the method was that of reducing the face value of each outstanding share and not that of reducing the number of outstanding shares.*"

In *Bynum vs. Commissioner*, 113 F. (2d) 1 (5th Cir.), it appeared that the petitioners deducted the cost of their stock from two dividends received from an oil company, contending that they were liquidating dividends. The Commissioner held that they were ordinary dividends and the

Board of Tax Appeals affirmed the Commissioner's ruling. There the company was incorporated in 1926 in Texas, and issued 112,500 shares of $1 par value. For some of its stock it acquired certain oil leases. Thereafter it drilled some wells and bought additional leases and lands. In 1935 it sold practically all of its assets, receiving some cash therefor, and paid a dividend of $1.50 per share to its stockholders, requiring the stock certificates to be turned in and have the liquidating dividend stamped thereon. The question was whether this was a cancellation or redemption of a part of the stock.

In reversing and remanding the case, the Court said:

> "While the facts are undisputed, the case presents a mixed question of fact and law. We are not bound by the decision of the Board and may draw our own conclusions from the facts. *Bogardus vs. Commissioner*, 302 U. S. 34, 58 S. Ct. 61, 82 L. Ed. 32.
>
> "We do not agree with the conclusions of either the Commissioner or the Board. Many corporations have stock of no par value. One dollar a share was nominal value only. The stockholders of a corporation have an equitable interest in the net assets of the corporation, after liabilities are liquidated, which is not necessarily measured by the par value of the stock. Each stockholder is entitled to receive his pro rata of the net assets in liquidation, according to the number of shares of the stock he holds, whether it is less or exceeds the par value. *The indorsement of the liquidating dividends on the stock certificates cancelled and redeemed them to that extent.*" (Italics ours).

In *Malone vs. Commissioner*, 128 F. (2d) 967 (5th Cir.), it was determined that the reduction of the capital of a National Bank by cutting the number of its shares did not produce taxable income to the stockholders, except on a

capital gain or loss basis. Pursuant to an approved plan, 8,000 shares of $100.00 par value were reduced to 4,000 shares of $100.00 par value, and $250,000.00 was distributed to the stockholders, pro rata. The Court, speaking through Judge Sibley, in terms sufficiently distinct to indicate the exact ground of his dissent in the case at bar, said:

> "Each stockholder surrendered his stock certificate and received another for half as many shares, and also $62.50 for each old share thus extinguished * * *. *Each stockholder of course retained the same proportionate interest in the bank's assets he had before* * * *. There was no reorganization, but only a reduction of the bank's capital. There was no exchange of stock for stock. Old certificates were surrendered and new ones issued, but of precisely the same kind, just as though the surrendered stock had been in fact sold to some third person and the certificate for the remaining shares had been issued to the seller. What is applicable is Section 115(i) * * *. It is conceded that a partial liquidation may occur *without an intention to discontinue business.* By the definition, it occurs when a part of the corporation's stock is completely cancelled or redeemed."

In spite of the fact that all three of the foregoing decisions were pressed upon the attention of the Circuit Court of Appeals, its opinion refers to none of them, except in a note it shows the *Bynum* case as applying to a series of distributions. Although in the *Malone* case it is distinctly shown that each stockholder after the reduction "retained the same proportionate interest in the bank's assets he had before", it is stated in the opinion of the Circuit Court of Appeals herein, as an argument against the effectiveness of this cancellation of a part of the stock, without noticing the *Malone* case, that "each stockholder still had the same

percentage of ownership, and would receive in final liquidation the same ratio of the corporate assets", and that "no stock was cancelled so as to permit each remaining share to receive a larger proportion in future distributions of the remaining assets."

In addition to the three decisions above reviewed, wherein the matter is fully discussed, the case of *Patty vs. Helvering*, 98 F. (2d) 717 (2d Cir.), in which the opinion was written by Circuit Judge L. Hand, also involved a reduction in the par value of each share of stock from $100.00 to $70.00, and in connection with its decision on the point which has been previously quoted (ante, p 12), it was said:

> "The Commissioner does not assert that the distributions at bar were not 'in complete cancellation or redemption' of a part of the company's shares, and arguendo, we therefore assume that they were."

The Holding of the Circuit Court of Appeals That a Reduction in Par Value Cannot Be a Partial Liquidation is Answered by the Facts Of This Case.

The Mexican Government had taken practically one-half of the Laredo Bridge Company's assets, and its capital had become impaired because the company received on this enforced sale only $75,000.00 as against the investment for the Mexican end of the bridge of more than $206,000.00, and the proceeds of this sale were no longer needed to carry on the curtailed business of the company. And so, *before* the distribution of the $135,000.00, comprising the two capital items of such proceeds of sale and the depreciation reserve for the lost Mexican end of the bridge, the stockholders reduced the capital of the Company by one-half. This was accomplished by regular methods appropriate to that end.

One of these was by endorsing each outstanding certificate of stock with the recital that the par value of each share was reduced one-half.

The evident aim of Subdivisions (c) and (i) of Section 115 was to exempt from usual income tax each stockholder's capital return on his investment. In order to come within Subdivisions (c) and (i) this return to him must be a distribution by the corporation in complete cancellation or redemption of a part of its stock. But the particular form that such cancellation or redemption must take is not specified in the law, and the restriction to capital value is effectuated just as certainly if part of the value of all the shares is cancelled completely as it is when a part of all of the shares is cancelled completely. In either event there is a cancellation of a part of the corporate stock. The result, rather than the form, is the important consideration.

A part of the stock is cancelled, whether it be a part of each share of stock or a part of the aggregate number of shares. In either case it is a capital distribution because of its source, and because equally in either event it is a distribution by a corporation "in complete cancellation or redemption of a part of its stock." Whether it is a part of each share or a part of the aggregate number of shares is immaterial.

What difference does it make that not a single share was completely cancelled? One-half of the par value of all the shares was completely cancelled, the reason for this being that practically one-half of the corporate assets, the toll bridge, was sold at an enforced loss, and the proceeds of this sale ratably distributed to the shareholders. The actual value of stock may be far in excess of its par value, and again, on the other hand, the par value may be far in excess of the actual value, but, after all, the par value is the basis for corporate capitalization.

Wilcox vs. Commissioner, 137 F. (2d) 136 (9th Cir.) *is Distinguishable.*

The *Wilcox* case presents the question as to the reduction in the par value of stock by two different corporations, the Inter-Island and the Pacific, the facts and rulings as to each being similar. Section 115 of the Revenue Act of 1934, as there involved, reads substantially like the same section in the Revenue Act of 1936, as here involved, but, in addition to construing Subdivisions (c) and (i) somewhat as the Courts below in our case do, the *Wilcox* case as to both corporations turned also on Subdivision (g) of this section, and that subdivision is not involved in any way in the case at bar as now presented (ante, pp. 5-6, 11-13). Thus, as to Inter-Island, the Court said:

> "If, contrary to our view, there was a cancellation or redemption, it was, we think, at such time and in such manner as to make the distribution and cancellation or redemption essentially equivalent to the distribution of a taxable dividend." (Citing Section 115(g)).

Then, under next to the last syllabus, almost the identical language is used about Pacific.

Neither of these corporations had made an enforced sale of substantially one-half of its assets at a loss, like the Laredo Bridge Company; nor had they disposed of any of their assets at all. Upon the contrary, there is said to have been no intention on the part of either of these corporations "to liquidate the corporation, either in whole *or in part*, or materially to curtail its business activities," and, as to Inter-Island, it is said that its policy was "to expand its operations as conditions should warrant."

Instead of the distribution as there involved being out of the proceeds of a sale of capital assets, as in our case,

it was there said as to Inter-Island "— a distribution which admittedly was made out of earnings and profits accumulated after February 28, 1913", and as to Pacific the same is said, and in addition:

> "The purpose of the reduction in capital was to distribute to the stockholders a portion of the accumulated earnings which were not required in the conduct of the business."

On the other hand, in the case at bar, the Commissioner's position is said by the Tax Court to "rest squarely upon the proposition that there was no partial liquidation of the corporation." (R. 29).

No more than the Circuit Court of Appeals in our case does the opinion in the Wilcox case even notice the previous decisions to the contrary of its holding on the reduction of the par value of stock being a complete cancellation of a part of such stock, to-wit, the *Straub* and *Bynum* cases, respectively from the third and fifth Circuits.

The Tax Court's Distinctions Are Without Any Real Difference.

The opinion of the Tax Court very well exposes one of its basic fallacies when it says:

> "There was no *complete* retirement of any part of the company's *shares of stock*, * as we understand the meaning of that term as used in Section 115(i) and the applicable regulations."

Apparently, the Honorable Tax Court overlooked the fact that the term used in Section 115(i) is not "shares of stock" at all, but just "stock", and a cancellation of a part of the stock can be effected just as certainly with a part of the value of all shares as it can be with respect to the full value of a certain number of shares. In either event, the

cancellation must be a complete cancellation—not an incomplete one.

As for the novel theory of the Tax Court that the *Straub* and *Bynum* cases are to be distinguished by the fact that each involved one of a series of distributions with the then present purpose of ultimate complete liquidation, as well as a reduction in the par value of stock, it presents a distinction without any reasonable difference. Like the Tax Court's attempted distinction of the *Quackenbos* case, that such case involves a complete cancellation of some of the shares of stock, as well as an absence of any purpose or intention whatever to wind-up the corporation, it undertakes to make the mere accidental incidents controlling. No reason is suggested why the reduction in the par value of stock comes within the definition of Subdivision (i) as being a complete cancellation of a part of the stock only when the corporation is in the process of complete liquidation, or why eventual liquidation of the corporation need not be contemplated only when the distribution is in complete cancellation of some of the shares of stock. The language as to an isolated cancellation or reduction is "of a part of its stock" and the language as to one of a series is "of all or a portion of its stock." "Part" and "portion" mean the same thing and "complete cancellation or redemption of all" would mean all value in all shares—a complete liquidation.

The truth about the matter is that the *Straub* and *Bynum* cases, combined with the *Quackenbos*, *Malone*, *Cordingley* and *Kelly* cases, make irrefutable authority for a reversal of this case, and those decisions come from the first, second, third and fifth Circuit Courts of Appeals, including some of the ablest Judges in the United States.

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*These last italics ours.

CONCLUSION.

It is, therefore, respectfully submitted that this case is one calling for the exercise by this Court of its supervisory powers by granting a writ of certiorari and thereafter reviewing and reversing the decision of the Circuit Court of Appeals.

By.....

L. G. SEELIGSON,
National Bank of Commerce Bldg.,
San Antonio 5, Texas,
Counsel for Petitioner.

SEELIGSON, COX & PATTERSON,
C. W. TRUEHEART,
San Antonio 5, Texas,
Of Counsel.

Counsel for Respondent are:

SAMUEL O. CLARK, JR.,
Assistant Attorney General of the United States,

SEWALL KEY,
RAY A. BROWN,
Special Assistants to the Attorney General of the United States,
Department of Justice,
Washington, D. C.

APPENDIX.

STATUTES INVOLVED.

(Revenue Act of 1936, 26 USCA, "Internal Revenue Acts," p. 868-871).

Section 115. Distributions by Corporations:

(a) Definition of dividend. The term "dividend" when used in this title * * * means any distribution made by a corporation to its shareholders, whether in money or in other property, (1) out of its earnings or profits accumulated after February 28, 1913, or (2) out of the earnings or profits of the taxable year * * * without regard to the amount of the earnings and profits at the time the distribution was made.

(b) Source of distributions. For the purpose of this Act every distribution is made out of earnings or profits to the extent thereof, and from the most recently accumulated earnings or profits. Any earnings or profits accumulated, or increase in value of property accrued, before March 1, 1913, may be distributed exempt from tax, after the earnings and profits accumulated after February 28, 1913, have been distributed, but any such tax-free distribution shall be applied against and reduce the adjusted basis of the stock provided in Section 113.

(c) Distributions in liquidation. Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation of a corporation shall be treated as in part or full payment in exchange for the stock. The gain or loss to the distributee resulting from such exchange shall be determined under Section 111, but shall be recognized only to the extent provided in Section 112 * * * In the case of amounts distributed * * * in

partial liquidation (other than a distribution within the provisions of subsection [h] of this section of stock or securities in connection with a reorganization) the part of such distribution which is properly chargeable to capital accounts shall not be considered a distribution of earnings or profits * *.

(f) Stock dividends.

(1) General rule. A distribution made by a corporation to its shareholders in its stock or in right to acquire its stock shall not be treated as a dividend to the extent that it does not constitute income to the shareholder within the meaning of the Sixteenth Amendment to the Constitution.

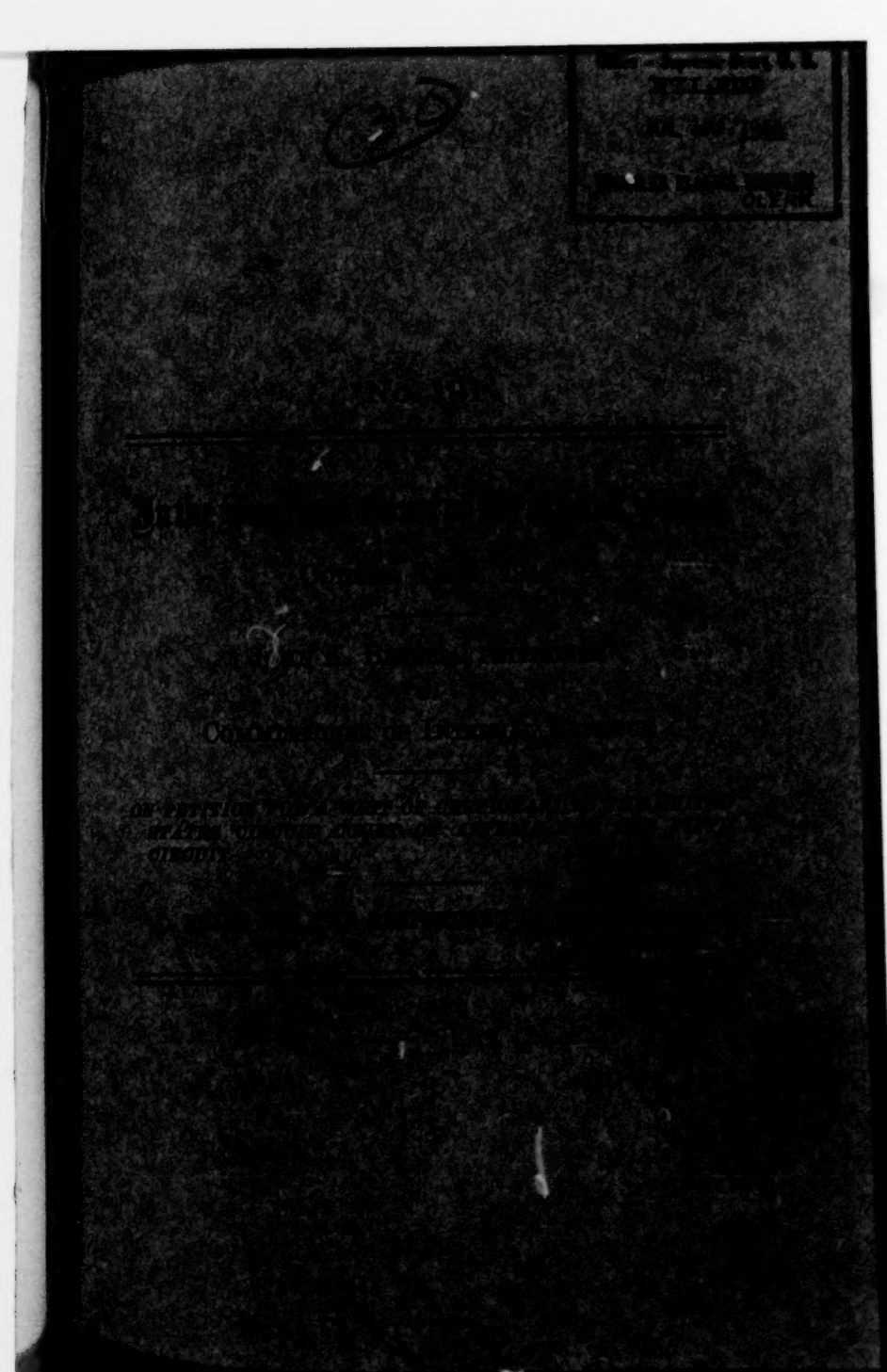
(g) Redemption of stock. If a corporation cancels or redeems its stock (whether or not such stock was issued as a stock dividend) at such time and in such manner as to make the distribution and cancellation or redemption in whole or in part essentially equivalent to the distribution of a taxable dividend, the amount so distributed in redemption or cancellation of the stock, to the extent that it represents a distribution of earnings or profits accumulated after February 28, 1913, shall be treated as a taxable dividend.

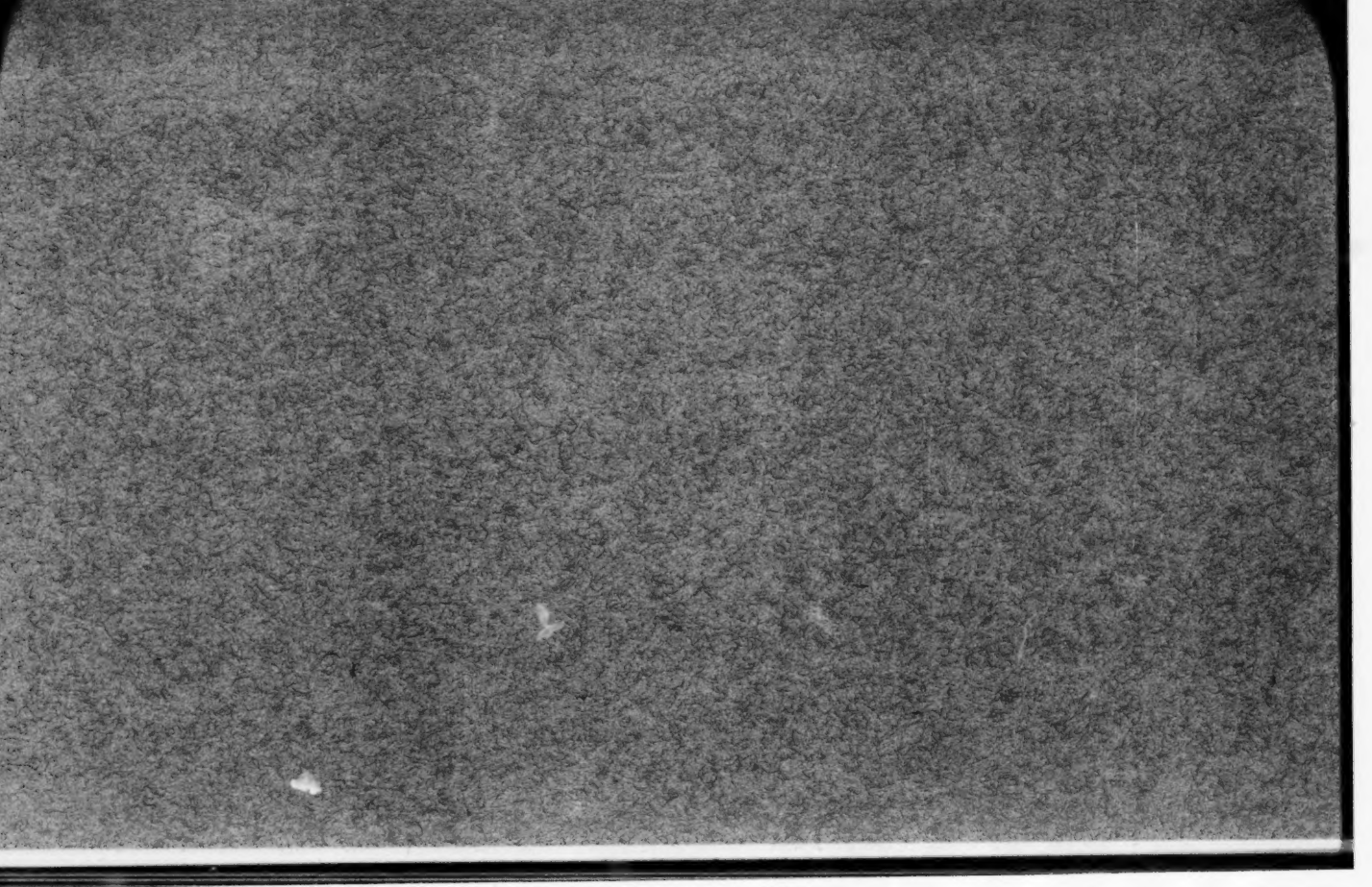
(h) Effect on earnings and profits of distributions of stock. The distribution (whether before January 1, 1936, or on or after such date) to a distributee by or on behalf of a corporation of its stock or securities or stock or securities in another corporation shall not be considered a distribution of earnings or profits of any corporation—

(1) if no gain to such distributee from the receipt of such stock or securities was recognized by law, or

(2) if the distribution was not subject to tax in the hands of such distributee because it did not constitute income to him within the meaning of the Sixteenth Amendment to the Constitution or because exempt to him under Section 115(f) of the Revenue Act of 1934 or a corresponding provision of a prior Revenue Act.

(i) Definition of partial liquidation. As used in this section the term "amounts distributed in partial liquidation" means a distribution by a corporation in complete cancellation or redemption of a part of its stock, or one of a series of distributions in complete cancellation or redemption of all or a portion of its stock.





INDEX

CITATIONS

599505—44——1

In the Supreme Court of the United States

OCTOBER TERM, 1944

No. 191

JOHN K. BERETTA, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Tax Court (R. 17–41) is reported at 1 T. C. 86. The opinion of the Circuit Court of Appeals (R. 87–93) is reported at 141 F. 2d 452.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on March 3, 1944 (R. 94). A petition for rehearing was denied on March 25, 1944 (R. 101). The petition for a writ of certiorari was filed on June 24, 1944. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether a distribution by a corporation to its stockholders was an ordinary dividend, or a distribution in partial liquidation of the corporation under Section 115 (c) and (i) of the Revenue Act of 1936, when the corporation did not cancel or redeem any of its shares but reduced the par value thereof from $100 to $50.

STATUTE AND REGULATIONS INVOLVED

The applicable statute and Regulations are printed in the Appendix, *infra*, pp. 14–18.

STATEMENT

The facts as stipulated (R. 52–71) and as found by the Tax Court (R. 19–27), insofar as they are material to the question presented, may be summarized as follows:

The taxpayer at all times material hereto was a stockholder in the Laredo Bridge Company (hereinafter referred to as the Company) a Texas corporation, the principal asset of which consisted of a toll bridge across the Rio Grande River between the cities of Laredo, Texas, and Nuevo Laredo, Mexico (R. 20, 53). The Company had been incorporated in 1902 with an original capitalization of $150,000, consisting of 1,500 shares of a par value of $100 each (R. 20, 53). On April 25, 1920, a fire destroyed the toll bridge and in order to raise the necessary funds for reconstruction, the capital stock of the Com-

pany was increased to $250,000 by the sale at par of 1,000 additional shares of a par value of $100 each (R. 21, 54). On April 11, 1922, the Company voted to increase its capital stock from $250,000 to $500,000. A 100% stock dividend of 2,500 shares was then declared and paid to stockholders of record out of earned surplus. The purpose of this last increase in capitalization was to reflect the increase in capital assets resulting from the new bridge. (R. 22, 56.)

The bridge owned by the Company was erected and operated under a concession by the Mexican Government and under a permit by the City of Laredo, Texas. The Mexican concession provided that at the end of fifty years the Mexican portion of the bridge should become the property of the Mexican Government, which would pay to the company two-thirds of its then appraised value. (R. 20, 53–54.) The franchise from the Mexican Government expired on June 6, 1937, and the Government then took over the Mexican portion of the bridge at a price of $75,962.28. This amount, less a transfer tax of $85.20, was received by the Company on July 24, 1937. (R. 22, 57, 58.)

On September 14, 1937, the directors of the Company voted to distribute to the stockholders the amount of $135,000, representing approximately the net proceeds of the sale to the Mexican Government and the depreciation reserve attributable

to the Mexican end of the bridge, and instructed the secretary to call a special meeting of the stockholders for the purpose of authorizing a reduction of the capital stock from $500,000 to $250,000 (R. 23–24, 61–62). At a special meeting held on October 12, 1937, the stockholders duly voted to approve and ratify a capital distribution of 27% ($135,000) to all stockholders of record and resolved that the capital stock of the Company be decreased from $500,000 to $250,000 and that the corporate charter be amended accordingly (R. 24–25, 65). The charter amendment was approved by the Secretary of State of Texas on October 23, 1937 (R. 66).

The reduction of the capital stock was accomplished by reducing the par value of each share of stock from $100 to $50 and there was endorsed on the face of each certificate the following (R. 26, 66):

> Authorized Capital Stock Decreased From $500,000 to $250,000 In Accordance With Resolution Of Stockholders At Meeting Held October 12, 1937, Par Value Each Share Reduced From $100 to $50.

Thereafter, the Company continued to operate the American side of the bridge and derived substantial income therefrom (R. 31, 69–71, 79–80).

In the latter part of 1937, the taxpayer and his wife, who reported income on the community

property basis (R. 52), received $23,706 of the $135,000 distributed in accordance with the plan described above, and none of this $23,706 was reported by them as taxable income[1] (R. 26, 66).

Before the Tax Court, the taxpayer contended that the $135,000 distributed by the Company was a capital distribution made in partial liquidation of the corporation under Section 115 (c) and (i) of the Revenue Act of 1936; and alternatively, if the distribution was not made in partial liquidation, it was a distribution out of capital, except for $45,006.73 thereof paid out of accumulated earnings, and should be applied to reduce the cost basis of his stock under Section 115 (d) (R. 27).[2] The Tax Court decided against taxpayer on both issues (R. 27–40), and the Circuit Court of Appeals affirmed the decision in both respects (R. 87–93). Only the holding with respect to whether the distribution was one in partial liquidation is involved in the petition for certiorari.

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[1] The same question as is involved in this case is presented in the case of the wife, now pending before the Circuit Court of Appeals. It was ordered by the court that her case is to be controlled by the final decision in the instant case (R. 82–83).

[2] The same contentions were made with respect to a distribution of $90,000 made in 1937 (R. 27), which the Company reported as a taxable dividend (R. 26). The Tax Court held against the taxpayer with respect to this distribution, and the taxpayer did not petition for a review of the holding by the Circuit Court of Appeals (see R. 47–50). Accordingly, the nature of this distribution is not before the Court.

ARGUMENT

The distribution of $135,000 was made out of accumulated earnings and profits (R. 92–93) [3] and is a taxable dividend under Sections 22 (a) and 115 (a) of the Revenue Act of 1936 (Appendix, *infra,* p. 14), unless it was a distribution in partial liquidation, as the taxpayer contends. If it was an amount distributed in partial liquidation, it is to be treated as a partial or complete payment in exchange for the stock. Section 115 (c) of the Revenue Act of 1936, *infra,* pp. 15–16.

Section 115 (i) defines the term "amounts distributed in partial liquidation" as—

> a distribution by a corporation in complete cancellation or redemption of a part of its stock, or one of a series of distributions in complete cancellation or redemption of all or a portion of its stock.

Since there was not a "series" of distributions in this case but only the one distribution in October, 1937, it is apparent that the first part of the definition is the only pertinent part. The precise question presented by the case, therefore, is whether the distribution of $135,000 was one in

[3] The court below held that the 1922 stock dividend of $250,000 (see Statement, *supra,* p. 3) did not reduce earnings and profits for dividend purposes (see Section 115 (h) of the Revenue Act of 1936) and that the distribution of $135,000 in 1937 must be deemed to have been made from the earnings represented in the 1922 stock dividend (R. 92–93). As indicated, the taxpayer has not made the correctness of this holding an issue in this Court (see Pet. 5).

complete cancellation or redemption of a part of the Company's stock.

There was no complete cancellation or redemption of any of the Company's stock in 1937, but only a reduction in the par value of all of the stock. The stockholders' resolution did not refer to cancellation or redemption of stock but simply authorized a decrease of the stock from $500,000 to $250,000 (R. 65), and this was accomplished by reducing the par value of all stock, rather than by cancelling or redeeming a part of it. After the distribution, the same stockholders owned the same number of shares and had the same proportional interest in the Company's assets. Accordingly, the holding of the Circuit Court of Appeals that there was not a complete cancellation or redemption of any part of the stock is correct and is in accord with *Wilcox* v. *Commissioner,* 137 F. 2d 136 (C. C. A. 9th).[4] See also

[4] The following texts also agree that a reduction in the par value of stock does not constitute a complete cancellation or redemption of any part of the stock under the statute: 1 Mertens, Law of Federal Income Taxation 551; 1 Paul & Mertens, Law of Federal Income Taxation 432; G. C. M. 8175, IX–2 Cum. Bull. 134 (1930).

The taxpayer seeks to distinguish the *Wilcox* case (Pet. 26–27) on the grounds that there the distribution was out of earnings and profits and that the corporation's activities were not curtailed through a sale of part of its assets. But since the Circuit Court of Appeals held that the distribution in this case is deemed to be out of earnings and taxpayer does not attack that holding in this Court, the first attempted distinction is without basis. The fact that assets were not

Article 115–5 of Treasury Regulations 94 (Appendix, *infra,* pp. 17–18), providing that a complete cancellation or redemption of a part of corporate stock may be accomplished by the complete retirement of all shares of a particular series, by taking up all the old shares of a particular series and issuing new shares to replace a portion thereof, or by the complete retirement of any part of the stock, whether or not *pro rata.*

The taxpayer states (Pet. 21–24) that the holding of the court below is in direct conflict with *Commissioner* v. *Straub,* 76 F. 2d 388 (C. C. A. 3d); *Bynum* v. *Commissioner,* 113 F. 2d 1 (C. C. A. 5th); *Malone* v. *Commissioner,* 128 F. 2d 967 (C. C. A. 5th); and *Patty* v. *Helvering,* 98 F. 2d 717 (C. C. A. 2d). We submit that there is no conflict.

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sold and the business was not curtailed in the *Wilcox* case is an immaterial difference. A contraction of business may or may not accompany a partial liquidation under the statute, but in any event the *Wilcox* case does not stand for the principle that every distribution following a partial contraction constitutes a partial liquidation. Cf. *Baker* v. *Commissioner,* 80 F. 2d 813 (C. C. A. 2d), and *Tate* v. *Commissioner,* 97 F. 2d 658 (C. C. A. 8th), certiorari denied, 305 U. S. 639, in which distributions by a corporation, even though from the proceeds of the sale of capital assets, were held not liquidating distributions since no cancellation or redemption of stock occurred.

The *Bynum* and *Straub* cases did not involve the question whether a single distribution was in complete cancellation or redemption of a part of stock, as does the instant case, but whether the distribution in question was "one of a series of distributions in complete cancellation or redemption of all * * * of its stock" under Section 115 (i).[5] In the *Malone* case, the capital of a corporation was reduced by calling in all outstanding stock for cancellation and reissuing one-half the number of shares of the same par value to the same stockholders together with cash. This constituted a partial liquidation under Article 115–5 of the Treasury Regulations. The *Malone* case, therefore, does not hold that a reduc-

[5] In both cases, the corporate resolution referred to the distribution as a liquidating dividend made in the process of discontinuing the business. Where a distribution is one of a series in cancellation of stock, it is manifestly not required that the stock be cancelled until it is entirely redeemed. And although a distribution made as one of the steps in the actual retirement and cancellation of all the stock is not prevented from being made in liquidation because no stock is then actually cancelled, it does not follow that a mere reduction in par value constitutes a cancellation or redemption when the very issue is whether stock has been cancelled or redeemed by such reduction. Moreover, the *Bynum* case did not involve a reduction in par value of stock but is a case where the amount of the liquidating distribution, which was one of a series of distributions, was endorsed on the stock certificates.

tion in par value constitutes a redemption or cancellation of stock. Nor does the *Patty* case so decide. There it was merely assumed by the court (p. 718), since no argument to the contrary was presented, that a reduction in par value was a complete cancellation or redemption of a part of the Company's shares. The issues actually decided were different.[6]

It is asserted (Pet. 24–25) that a partial liquidation must have occurred when a part of each share of stock was cancelled equally as if a part of the total number of shares had been cancelled. We believe that a reduction in par value does not cancel or redeem a part of each share. But in any event, the statute defines partial liquidation as complete cancellation of part of the stock and not as partial cancellation of all the stock. Although the Company could have effected a partial liquidation by completely cancelling one half of its stock, it did not do so; and the tax effect of the transaction must be

[6] In the *Patty* case, the question whether the distributions were in partial liquidation of the corporation was not in issue. The Commissioner, for the purpose of the appeal, assumed that they were, but contended nevertheless that the distribution was out of earnings and profits and taxable as an ordinary dividend under Section 115 (a) and (b), or else was taxable under Section 115 (g) as being "essentially equivalent to the distribution of a taxable dividend," the only questions determined by the court.

governed by what was done and not what might have been done. See *Davidson* v. *Commissioner,* 305 U. S. 44, 46.

The contention (Pet. 20–21, 27–28) that the word "stock" in Section 115 (i) refers to the stockholders' intangible interest in the corporation, rather than stock certificates or shares of stock, is without merit. The administrative construction of the word "stock" is inconsistent with the taxpayer's view (Article 115–5, Treasury Regulations 94) as is *Wilcox* v. *Commissioner,* 137 F. 2d 136 (C. C. A. 9th). But even if the term is assumed *arguendo* to refer to the shareholder's interest in the corporation, there was no complete cancellation or redemption of part of that interest by a reduction in the par value of the stock, for each shareholder retained the same proportional interest in the corporate assets.

The taxpayer attacks (Pet. 14–19) the holding of the court below that the distribution of $135,000 was not one in partial liquidation because there was no evidence that it was made with intent to wind up, or to initiate a process of winding up, the corporate affairs. Since we have shown that the distribution and the concomitant reduction in par value did not effect a complete cancellation or redemption of part of the stock within the statutory definition of a partial liquidation,

it is immaterial whether the distribution was connected with an intent to liquidate or curtail the business.[7] It is true that the decisions in *Commissioner* v. *Quackenbos,* 78 F. 2d 156 (C. C. A. 2d); *Commissioner* v. *Cordingley,* 78 F. 2d 118 (C. C. A. 1st); and *Kelly* v. *Commissioner,* 97 F. 2d 915 (C. C. A. 2d), indicate that a distribution in complete cancellation or redemption of a part of the stock is a partial liquidation even though there was no intent to wind up the corporate affairs in other respects. Cf. *Malone* v. *Commissioner,* 128 F. 2d 967 (C. C. A. 5th). But those cases do not hold that a partial liquidation results where there is no complete cancellation or redemption of any part of the stock, but only a reduction in par value of all the stock as in the instant case. Consequently they do not conflict with the decision below on the controlling issue, even though they may be inconsistent with the deci-

[7] The Circuit Court of Appeals was, however, justified in concluding that the distribution was not made with the intent to wind up, or to initiate the process of winding up, the corporate affairs (R. 92). The sale of the Mexican part of the bridge occurred, not because the Company was curtailing its business, but in order to comply with the terms of its franchise (R. 20, 22). Such a sale was always contemplated from the time the Company commenced to do business as a necessary incident of doing business. After the sale, the Company continued to operate the American side of the toll bridge, earning substantial income, and the record is barren of any indication that discontinuance of that business was contemplated.

sion below as to the necessity for a liquidating intent.[8]

CONCLUSION

The judgment of the court below is correct and presents no conflict requiring a decision by this Court. The petition for a writ of certiorari should therefore be denied.

Respectfully submitted.

CHARLES FAHY,
Solicitor General.

SAMUEL O. CLARK, JR.,
Assistant Attorney General.

SEWALL KEY,
HELEN R. CARLOSS,
HELEN GOODNER,
Special Assistants to the Attorney General.

WALTER J. CUMMINGS, JR.,
Attorney.

JULY 1944.

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[8] As the taxpayer suggests (Pet. 15), a liquidating intent is manifestly necessary, under the second definition of a partial liquidation contained in Section 115 (i), to prove that a distribution is one of a series of distributions in complete cancellation or redemption of all or a portion of the stock. See, *e. g.*, *Holmby Corp.* v. *Commissioner*, 83 F. 2d 548 (C. C. A. 9th); *Canal-Commercial T. & S. Bk.* v. *Commissioner*, 63 F. 2d 619 (C. C. A. 5th), certiorari denied, 290 U. S. 628; *Neptune Meter Co.* v. *Price*, 98 F. 2d 76 (C. C. A. 2d).

APPENDIX

Revenue Act of 1936, c. 690, 49 Stat. 1648:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * * *

SEC. 115. DISTRIBUTIONS BY CORPORATIONS.

(a) *Definition of Dividend.*—The term "dividend" when used in this title (except in section 203 (a) (3) and section 207 (c) (1), relating to insurance companies) means any distribution made by a corporation to its shareholders, whether in money or in other property, (1) out of its earnings or profits accumulated after February 28, 1913, or (2) out of the earnings or profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made.

(b) *Source of Distributions.*—For the purposes of this Act every distribution is made out of earnings or profits to the extent thereof, and from the most recently accumulated earnings or profits. Any earnings or profits accumulated, or increase in value of property accrued, before March 1, 1913, may be distributed exempt from tax, after the earnings and profits accumulated after February 28, 1913, have been distributed, but any such tax-free distribution shall be applied against and reduce the adjusted basis of the stock provided in section 113.

(c) *Distributions in Liquidation.*—Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation of a corporation shall be treated as in part or full payment in exchange for the stock. The gain or loss to the distributee resulting from such exchange shall be determined under section 111, but shall be recognized only to the extent provided in section 112. Despite the provisions of section 117 (a), 100 per centum of the gain so recognized shall be taken into account in computing net income, except in the case of amounts distributed in complete liquidation of a corporation. For the purpose of the preceding sentence, "complete liquidation" includes any one of a series of distributions made by a corporation in complete cancellation or redemption of all of its stock in accordance with a bona fide plan of liquidation and under which the transfer of the property under the liquidation is to be completed within a time specified in the

plan, not exceeding two years from the close of the taxable year during which is made the first of the series of distributions under the plan. In the case of amounts distributed (whether before January 1, 1934, or on or after such date) in partial liquidation (other than a distribution within the provisions of subsection (h) of this section of stock or securities in connection with a reorganization) the part of such distribution which is properly chargeable to capital account shall not be considered a distribution of earnings or profits.

* * * * *

(h) *Effect on Earnings and Profits of Distributions of Stock.*—The distribution (whether before January 1, 1936, or on or after such date) to a distributee by or on behalf of a corporation of its stock or securities or stock or securities in another corporation shall not be considered a distribution of earnings or profits of any corporation—

(1) if no gain to such distributee from the receipt of such stock or securities was recognized by law, or

(2) if the distribution was not subject to tax in the hands of such distributee because it did not constitute income to him within the meaning of the Sixteenth Amendment to the Constitution or because exempt to him under section 115 (f) of the Revenue Act of 1934 or a corresponding provision of a prior Revenue Act.

As used in this subsection the term "stock or securities" includes rights to acquire stock or securities.

(i) *Definition of Partial Liquidation.*—As used in this section the term "amounts

distributed in partial liquidation" means a distribution by a corporation in complete cancellation or redemption of a part of its stock, or one of a series of distributions in complete cancellation or redemption of all or a portion of its stock.

* * * * *

Treasury Regulations 94, promulgated under the Revenue Act of 1936:

ART. 115–5. [As amended by T. D. 4759, 1937–2 Cum. Bull. 117, and T. D. 4784, 1937–2 Cum. Bull. 136.] *Distributions in liquidation.*—Amounts distributed in complete liquidation of a corporation are to be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation are to be treated as in part or full payment in exchange for the stock so canceled or redeemed. * * *

* * * * *

In the case of amounts distributed in partial liquidation of a corporation, the amount of the loss recognized is subject to the limitations contained in section 117 but the entire amount of the gain recognized shall be taken into account in computing net income despite the provisions of section 117. The term "amounts distributed in partial liquidation" means a distribution by a corporation in complete cancellation or redemption of a part of its stock, or one of a series of distributions in complete cancellation or redemption of all or a portion of its stock. A complete cancellation or redemption of a part of the corporate stock may be accomplished, for example, by the complete retirement of all

the shares of a particular preference or series, or by taking up all the old shares of a particular preference or series and issuing new shares to replace a portion thereof, or by the complete retirement of any part of the stock, whether or not pro rata among the shareholders.

* * * * *

U. S. GOVERNMENT PRINTING OFFICE: 1944

(30)

Supreme Court of the United States

OCTOBER TERM, 1944.

No. 191.

JOHN K. BERETTA, PETITIONER,

versus

COMMISSIONER OF INTERNAL REVENUE,
RESPONDENT.

PETITIONER'S REPLY TO THE BRIEF FOR RESPONDENT IN OPPOSITION.

L. G. SEELIGSON,
National Bank of Commerce Building,
San Antonio 5, Texas,
Counsel for Petitioner.

SEELIGSON, COX & PATTERSON,
C. W. TRUEHEART,
San Antonio 5, Texas,
Of Counsel.

LODOVIC PRINTING CO., SAN ANTONIO, TEXAS

SUBJECT INDEX.

LIST OF AUTHORITIES.

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COMMISSIONER OF INTERNAL REVENUE,
RESPONDENT.

PETITIONER'S REPLY TO THE BRIEF FOR RESPONDENT IN OPPOSITION.

Under leave of the Court, Petitioner herewith presents a short reply to Respondent's Brief. The reasons prompting this are—

FIRST: Since the filing of the Petition and Supporting Brief, the Second Circuit Court of Appeals, speaking through Judge Augustus N. Hand, has handed down another decision, in direct conflict with the decision of the courts below, to-wit: *Estate of Edward T. Bedford, Title Guaranty & Trust Co., Executor, vs. Commissioner of Internal Revenue,* (as yet unpublished), a copy of which is set out in appendix of this brief;

SECOND: Respondent's Brief, when properly analyzed, constitutes a virtual confession of error.

UNDISPUTED MATTERS.

It will be noted that the "Question Presented", as posed in Respondent's Brief, is shorn of the factual element of a want of intent or purpose to completely liquidate or dissolve. Apparently, this is because no issue is taken with Petitioner on such intent not being essential to a partial liquidation by a single distribution, as distinguished from one of a series of distributions. On pages 12-13 of Respondent's Brief, it is admitted that the authorities relied upon by Petitioner (Pet. 7) so hold, and conceded that "they may be inconsistent with the decision below as to the necessity for a liquidating intent" (here meaning intention to *wind up or dissolve*), and Petitioner on his part makes no question about the absence of such intent, under the facts.

Thus, the most insistently repeated basis for the decision below is destroyed[1].

This matter is not briefed by Respondent because regarded as "immaterial" in view of the "controlling issue" (Respondent's Brief 11-12)—whether a reduction in the par value of corporate stock can be a complete cancellation or redemption of a part of such stock (Pet. 7, 32).

As affecting this one indisputable issue, the facts adduced in Respondent's Brief (2-5), though fuller than set out in the Petition (2-4), in no way vary the latter, and it is to be noted that Respondent does not try to give any effect to the additional corporate history stated in the paragraph extending from page 2 to page 3 of his Brief.

Respondent's Brief does not in terms admit that the Honorable Judge writing the opinion for the Circuit Court of Appeals herein got somewhat tangled in the intricacies

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1 The necessity of the intent to dissolve is mentioned in every paragraph of the opinion (141 Fed. p 454-5) discussing the contention of partial liquidation, syllabi 1 to 4).

of income tax law when he undertook to declare, as additional basis for decision against Petitioner, that the distribution in question was made out of accumulated earnings and profits (Pet. 5-6, 12-13). Yet Respondent's Brief frankly says on page 6 that this distribution was out of accumulated earnings and profits and taxable, "*unless* it was a distribution in partial liquidation"; thereby plainly implying, just like the Tax Court[1], that, if this was a distribution in partial liquidation, it was not taxable[2].

Thus again, we return to the only thing disputed in this case, to-wit: Whether a reduction in the par value of a corporation's stock is a "complete cancellation or redemption of a part of said stock", within the definition of Section 115(i) of the 1936 Revenue Act.

The only facts possibly helpful for the determination of this matter, beyond those shown on pages 3-4 of Respondent's Brief or pages 2-4 of the Petition, are the following:

(1). The distribution to the stockholders was made from the enforced sale of the Mexican end of the bridge, a capital asset, in that the $135,000.00 distributed (out of which the taxpayer received $23,706.00) represented the net proceeds ($75,877.48) of the sale to the Mexican Government and most of the depreciation reserve ($62,029.89) attributable to the Mexican end of the bridge (R. 73, 23-4, 58-62).

(2). This sale represented a net capital loss of $68,-630.53 as against an investment cost in the Mexican end of the bridge of $206,536.90 (R. 60).

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[1] See its opinion as quoted on page 6 of the Petition.

[2] In addition to the cases cited on page 12 of the Petition as supporting this rule, see **Foster** vs. **United States**, 303 U. S. 118, 121, 58 S. Ct. 424, and **Fowler Bros. & Cox** vs. **Commissioner**, 138 F. (2d) 774, 776 (C. C. A.—6th), and the **Bedford** case, post, 16.

(3). The good faith of this distribution and the good faith of the reduction in the par value of the stock has never been questioned by the Commissioner.

(4). After this distribution, only the American side of the bridge was owned by Laredo Bridge Company, and, though it still operated so as to earn substantial dividends (R. 79), this sale of the Mexican end of the bridge "decreased the earnings of the company by about 40%" (R. 73).

WAS THIS "A DISTRIBUTION BY A CORPORATION IN COMPLETE CANCELLATION OR REDEMPTION OF A PART OF ITS STOCK"?

Purpose of the Law.

In undertaking to answer this question, Respondent's Brief gives no consideration to the reason behind the law, which must have been to exempt from ordinary income tax a stockholder's capital return on his investment. Accepting this as the purpose of the law, we can hardly imagine that it could be served (a) by construing "stock" in the above language of the law to mean *shares* or *certificates of stock*, or (b) by construing this language so as to exclude a complete cancellation of part of the value of each share, or (c) by construing this language to include a distribution in full cancellation or redemption of a part of the value of each share *only* when the corporation is in process of a complete liquidation, but to exclude a distribution in full cancellation or redemption when the corporation is making only a single distribution, without intended dissolution.

Looking to the substance of things, a restriction to *capital* values is the aim of this statutory definition.

THE WORD "STOCKS" IN THE DEFINITION.

The New York Court of Appeals in *Burr vs. Wilcox*, 22 N. Y. 551, 556, through Judge Selden, held that, though the word "stock" is "sometimes used to designate the certificates", "this is an *inappropriate* use of the word."

Cook on Stock, Stockholders and Corporations, Section 12, defines stock "as a proportionate part of certain rights in the management and properties of a corporation during its existence and in the assets upon its dissolution."

If Congress, in Section 115(i), was "speaking of *stock* in a broader sense than mere certificates", rather than making such latter inappropriate use of the word "stock", then, as suggested by presiding Judge Murdock in his dissenting opinion herein (R. 41), "there would be the same cancellation", "regardless of whether one-half of the stock certificates are cancelled, or whether the par value of each certificate is cut in two."

It would be a partial liquidation, within the law, when construed in the usual sense of the words used, when there was a complete (that is, full and absolute) cancellation or redemption of a part of the corporate stock. In other words, once we sever the word *"stock"* from the narrow meaning given it by Respondent, there would be a complete cancellation of a part of the *stock*, although there was only a partial cancellation of all of the stock certificates.

Can it be reasonably supposed that Congress intended to make an arbitrary distinction between capital values by including in this definition a corporate distribution in complete cancellation of a part of its stock certificates and at the same time excluding therefrom a corporate distribution in complete cancellation of a part of all of its stock?

The only thing suggested by Respondent, besides the Wilcox case, later discussed, post page 11, to support such

an arbitrary distinction is Article 115-5, Treasury Regulations 94. When, however, we read this Treasury regulation (Res. Br. 17-18), we find a definition absolutely identical in language with the law itself, and it is followed by several examples of "complete cancellation or redemption", the third and last of which is said to be "by the complete *retirement* of any part of the *stock*, whether or not pro rata among the shareholders."

Certainly, there is nothing more in this example than in the definition in the statute and regulations to require the meaning of *stock certificates* for the word *stock* as used therein. As for the word "retirement", this Court in *McClain vs. Commissioner*, 311 U. S. 527, 530, says;

> "In common understanding and according to dictionary definition the word 'retirement' is broader in scope than 'redemption'; is not, as contended, synonomous with the latter, but includes it. Nothing in the legislative history of the provision requires us to attribute to the term used a meaning narrower than its accepted meaning in common speech."

REDUCTION IN PAR VALUE.

Respondent does not claim any legislative history for this provision (Sec. 115[i]) that requires us to attribute to the term *stock*, any more than the term *retirement*, a meaning narrower than its accepted meaning in common speech. By construing "stock" to mean the stockholder's proportional interest in the corporation, we avoid the arbitrary distinction suggested in the question several paragraphs above. Congress, then, cannot be presumed to have used the word "stock" in a narrow and inappropriate sense when the ordinary meaning avoids inconsistencies and inequalities.

It is somewhat vaguely contended by Respondent that a reduction in the par value of corporate stock does not in any event constitute a complete cancellation or redemption of a part of such stock. No reason is given why the statute should be given the peculiar meaning claimed for it, and many reasons have heretofore been shown by us why it should not be so restricted. (Pet. 20-1, 24-5).

Of course, par value is face value, and face value is presumptive market value, and when the capitalization of this corporation was reduced by one-half and each share of its stock correspondingly reduced, each stock certificate was fully and completely cancelled in part; that is, to the extent of one-half, and any partial liquidation was thus effected.

We have in the Petition cited a number of cases holding that a reduction in the par value of stock was a complete cancellation or redemption of a part of such stock (7-8). Equally appropriate are other cases where there has been a reduction in capitalization by means of a reduction in the number of shares.

An example of this class of cases is found in *Kelly vs. Commissioner*, 97 F. (2d) 917 (C. C. A. 2nd), wherein in reducing the capitalization by one-half the number of shares was reduced from 160,000 to 80,000 and the same par value of $25.00 for each continued, and with reference to the sufficiency of such proceeding under Section 115(i), it was said by the Court, speaking through Judge Manton:

> "In the instant case it was a return of capitalization, not a dividend. The corporation returned to its stockholders 50% of the capitalization."

Another illustration of the same class of cases is found in *Commissioner vs. Quackenbos*, 78 F. (2d) 156 (C. C. A.—2nd), and still another in *Commissioner vs. Cordingley*, 78

F. (2d) 118 (C. C. A.—1st), for in both of those cases there was a reduction of capitalization effected by means of a reduction in the number of shares, rather than in the par value of each share.

Certainly, the capital loss is the same whether the reduction in capitalization be effected by means of diminishing the number of shares or by diminishing the par value of each share. The cases stand on a parity, and either form the reduction takes it is equally within the definition of Section 115(i).

And this brings us to the point that thus the distinction without a difference sought to be made by the Tax Court (See Petition 17-18, 27) is completely destroyed, for it will be recalled that the Quackenbos and Cordingley cases directly held that an intent to dissolve the corporation was not essential to a partial liquidation, such partial liquidation in those cases being effected by means of a reduction in corporate capitalization. We have in them a union of both features of the instant case, and the reason for the Tax Court's decision is thereby eliminated.

Malone vs. Commissioner, 128 F. (2d) 967 (C. C. A.—5th) (Pet. 22-4) is another case that belongs to this class where reduction of capitalization is attained by cutting the number of shares, and it, of course, exemplifies the reason for Judge Sibley's dissent in the case at bar. The argument of the Circuit Court of Appeals (bottom first column, 141 F. (2d 455), which is repeated again on page 7 of Respondent's Brief, that after the distribution the stockholders held the same proportional interest in the company's assets as before, is met by the holding of Judge Sibley, in the light of the fact recited by him that "each stockholder, of course, retained the same proportionate interest in the bank's assets he had before."

Coupling the language of this opinion with his dissent in our case, it is apparent that in the Malone case Judge Sibley virtually holds that a complete cancellation or redemption of a part of the corporation's stock is effected by a reduction in capitalization, regardless of whether this is accomplished by means of diminishing the par value of each share or by diminishing the number of shares.

PETITIONER'S PRINCIPAL AUTHORITIES REVIEWED.

The Circuit Court of Appeals herein gave no consideration whatever to the authorities cited on pages 7 and 8 of the Petition, though they were all pressed upon its attention. The opinion itself cites nothing but *Wilcox vs. Commissioner*, 137 F. (2d) 136, as supporting its holding that reduction in par value of stock is not a complete cancellation or redemption of a part of such stock.

Respondent, however, cites some additional authorities and undertakes to distinguish the cases relied upon by Petitioner.

He correctly says (Br. 9) that *Bynum vs. Commissioner*, 113 F. (2d) 1 (C. C. A.—5th), and *Commissioner vs. Straub*, 76 F. (2d) 388 (C. C. A.—3rd) do not involve a single distribution, but "one of a series of distributions". It is for this reason that it was necessary in those cases that there be an intent to dissolve the corporation, and it is precisely because of this that those cases emphasize the presence of such intent. But no reason has been, nor we believe can be*, given why the reduction in the par value of the stock comes within Subdivision (i) in one case and not in the other.

We therefore again stress the *Straub* case (Pet. 21) as being indistinguishable and in plain conflict with the deci-

*See Pet. 28.

sion below. The only distinction offered by Respondent is that the case involves "one of a series of distributions." What difference that makes as rendering a reduction in par value a complete cancellation or redemption of a portion of the stock is not explained.

Thus, in final analysis, Respondent's Brief stands on the same distinction without a difference undertaken to be made by the Tax Court.[1] That Court is just franker than Respondent about admitting the force of the *Straub* and *Bynum* cases, when it says that if this distribution had been one of a series—

> "then the fact that none of the corporation's shares were cancelled and retired as a result of the distribution would not be material and the method used of reducing the par value of the stock from $100.00 to $50.00 per share would be sufficient, and the cases of Bynum vs. Commissioner, 113 F. (2d) 1, and Commissioner vs. Straub, 76 F. (2d) 388, affirming 29 B. T. A. 216, would be in point."

Respondent's Authorities Reviewed.

On page 7 of Respondent's Brief several nonjudicial authorities are cited as supporting his contention. One of these is 1 Paul & Mertens, Law of Federal Income Taxation 432, where it is said:

> "A mere reduction of par value is not, *it would seem*, a redemption or cancellation."

Our emphasis is to show that this idea was not even agreed to by the authors, its basis being indicated as the opinion of the General Counsel of the Treasury Department,

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[1] See Pet. 27-8.

which is the same opinion partly set forth in the Tax Court's opinion herein (R. 33-4).

The interesting thing about this is that a comparison of the facts develops that the same identical case passed upon by the General Counsel was the one in which the taxpayer prevailed before the Second Circuit Court of Appeals in *Patty vs. Helvering*, 98 F. (2d) 717, the facts of which are virtually identical with the facts in the case at bar. Evidently, the Commissioner in that case disagreed with the opinion of his counsel, and therefore did not even assert that the distribution was not in complete cancellation or redemption.

This leaves virtually nothing but the *Wilcox* case to support Respondent's contention. The main distinctions in it we have previously pointed out (Pet. 26-7), they being in substance that there the distribution was taxable as being out of earnings and profits and that the several distributions there made were not out of the proceeds of a sale of capital assets as in our case.

Respondent's Brief (p. 78) criticizes the first of these distinctions by the suggestion that we have not even attacked the holding of the Circuit Court of Appeals herein that the distribution here was taxable as being out of earnings and profits. The reason why we did not do so is because we firmly relied upon the definite commitments of counsel for the Commissioner that, under the circumstances here present, this distribution, though out of accumulated earnings and profits, was not taxable if it was a distribution in partial liquidation.* We may add that we still firmly rely upon that commitment as shown in the first paragraph of the argument on page 6 of Respondent's Brief.

The second of the above mentioned distinctions may

*See ante, p. 2, for the Commitment, Note 2 for the Authorities.

be more fully and effectively stated in this wise: The amount distributed here was the proceeds of the sale of the Mexican end of the bridge and the depreciation reserve attributable thereto, and the corporation thereafter operated with diminished assets and 40% less profit. On the other hand, in the Wilcox case the distribution was not made out of any kind of capital assets, but out of excess earnings, and the business was thereafter operated without material curtailment. In our case there was a partial liquidation of the corporation, in the Wilcox case there was none.

Respondent says that the fact that there were no assets sold and no curtailment of business in the Wilcox case is "an immaterial difference." Of course, there must needs be a cancellation or redemption of stock in connection with such sale of assets, but it occurs to us that the fact that the distribution here involved was indisputably made out of a sale of capital assets, to-wit, the Mexican end of the bridge, constitutes not only a material difference, but strikes at the very heart of the idea of putting capital returns upon a different basis from ordinary income returns.

In addition, the distribution in the Wilcox case seems to have been made for the deliberate purpose of tax evasion, while there is no suggestion of that in our case.

ESTATE OF EDWARD T. BEDFORD, TITLE GUARANTY & TRUST CO., EXECUTOR, VS. COMMISSIONER.

This is the style of a case decided on August 8, 1944, by the United States Circuit Court of Appeals for the Second Circuit, the opinion being written by Circuit Judge Augustus N. Hand. Since this case is directly in point and is as yet unpublished, for the convenience of the Court we set out the opinion entire in an appendix hereto in accord-

ance with an official copy of the opinion furnished to us by the Clerk of the Court.

Like the *Straub* case, this case is directly in point on the second of the two propositions involved, whether reduction in par value of stock is a complete cancellation or redemption of a part of such stock. The decision of the Circuit Court of Appeals herein is therefore in direct conflict with the decision in the *Bedford* case.

The facts involved in the *Bedford* case are, in brief: The appeal involves income taxes of the estate of Edward T. Bedford, deceased, for 1937 (the same year as involved in the case at bar), and is taken from a decision of the Tax Court sustaining the assessment and adjudging a deficiency, and the Circuit Court of Appeals reverses the Tax Court. On account of a deficit in its surplus account, Abercrombie & Fitch Co. at a meeting of stockholders adopted a plan of recapitalization, under which the estate received in 1937, in exchange for its 3,000 shares of preferred stock, $100.00 par value, in that corporation, 3,500 shares of another class of preferred stock of the par value of $75.00; 1500 shares of its common stock of the par value of $1.00, and cash of $15.08 per share. The stock thus given in exchange was not subject to taxation because received through a re-organization under the provisions of Section 112(b)(3) of the Revenue Act, and the cash of $45,240.00 was concededly taxable as a part of the gain. The Commissioner, however, contended, and the Tax Court held, that the cash distribution, under the plan of re-organization, had "the effect of a distribution of a taxable dividend."

The corporation was not intended to be dissolved, though no discussion is made of this phase of the matter.

The Circuit Court of Appeals holds, in the first place, "that when earnings are once capitalized by the issue of stock dividends, they are no longer earnings, but capital,

except in cases where the purpose of the transaction is not an honest business transaction, but one to avoid taxation", and that "under those decisions (*Commissioner vs. Quackenbos*, 78 F. (2d) 156; *Patty vs. Helvering*, 98 F. (2d) 717; and *DeNobili Cigar Company vs. Commissioner*, 143 F. (2nd) 436), the distribution here was a liquidating dividend and not an ordinary dividend."

It holds in the second place, that even if the distributions "might have been taken out of accumulated earnings, these distributions should have been charged to capital rather than surplus".

Finally, and most important, it holds as follows:

> "The distribution here was a 'partial liquidation' because all of the old stock of the par value of $300,000.00 was surrendered by the decedent for new stock having a par value of only $264,000.00 (3500 shares of preferred stock with a par value of $75.00, and 1500 shares of common stock with a par value of $1.00). The transaction was evidently a distribution by Abercrombie & Fitch Co. 'in complete cancellation or redemption of a part of its stock.' Such a distribution is a partial distribution as defined in Section 115(i) of the Revenue Act. Hammans vs. Commissioner, 121 F. (2d) 4, 7."

The only difference between that case and the case at bar is that there the reduction in the par value of the taxpayer's stock was effected by an exchange of the old stock for new stock having a less par value, while in the case at bar, the reduction in par value of the shares from $100.00 to $50.00 per share was effected by an endorsement on the certificates of stock held by the taxpayer. In that case there was a cash distribution of $45,240.00 to the taxpayer, and in ours there was a cash distribution of $23,706.00.

If there was a "partial liquidation", "in complete cancellation or redemption of a part of its stock", in the *Bedford* case, there was equally such a partial liquidation, within the sense and meaning of Section 115(i), in the case at bar.

CONCLUSION.

It is submitted that, in view of the plain conflict of decisions and the importance of the question, the writ prayed for should be granted and the decision of the Circuit Court of Appeals herein reversed.

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L. G. SEELIGSON,
National Bank of Commerce Building,
San Antonio 5, Texas,
Counsel for Petitioner.

SEELIGSON, COX & PATTERSON,
C. W. TRUEHEART,
National Bank of Commerce Building,
San Antonio 5, Texas,
Of Counsel.

APPENDIX.

UNITED STATES CIRCUIT COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 93—October Term, 1943.

(Argued January 6, 1944 Decided August 8, 1944.)

ESTATE OF EDWARD T. BEDFORD, TITLE GUARANTEE AND TRUST COMPANY, Executor,

Petitioner,

—against—

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Before:

L. HAND, AUGUSTUS N. HAND and CHASE,

Circuit Judges.

Petition by Title Guarantee and Trust Company, Executor of the Will of Edward T. Bedford, deceased, to review an order of the Tax Court of the United States determining a deficiency of $13,887.24 on the part of the Estate of Edward T. Bedford in income taxes for the calendar year 1937. Reversed.

HOLT S. MCKINNEY, Attorney for Petitioner; Erwin R. Griswold and Holt S. McKinney, Counsel.

SAMUEL O. CLARK, JR., Assistant Attorney General, Sewall Key and Helen Goodner, Special Assistants to the Attorney General, for Respondent.

AUGUSTUS N. HAND, *Circuit Judge*:

This appeal involves income taxes of the Estate of Edward T. Bedford, deceased, for 1937, in the amount of $13,887.24 and is taken from a decision of the United States Tax Court sustaining the assessment of the Commissioner of Internal Revenue. We think the decision of the Tax Court adjudging a deficiency of $13,887.24 should be reversed.

Edward T. Bedford died on May 21, 1931, and Title Guarantee and Trust Company is the executor of his estate and the taxpayer in this proceeding. Among his assets were 3,000 shares of 7% cumulative preferred stock of Abercrombie and Fitch Company (par value $100 per share) having a fair market value at the date of his death of $210,000. Because of business conditions prevailing in the years following Bedford's death Abercrombie and Fitch Company *incurred losses*, with the result that its surplus account showed a cumulative deficit of $399,771.87 on January 31, 1936. Included in charges against its surplus were amounts aggregating $844,100 which had been capitalized by three stock dividends issued in 1920, 1928 and 1930. Because of the *deficit occasioned* in the surplus account the Company had been unable for over five years to pay dividends on either its preferred or common stock. Accordingly a plan of recapitalization was proposed and submitted to the stockholders for their consideration and

approval and was adopted by them at a meeting held on December 8, 1936, and thereafter put into effect.

In accordance with this plan, the executor of Bedford received in January, 1937, in exchange for its 3,000 shares of 7% cumulative preferred stock ($100 par value), the following:

		Fair Market Value
3,500	shares new Cumulative Preferred Stock of the Abercrombie and Fitch Company of a par value of $75. per share and an annual dividend of $6. per share	$288,750.
1,500	shares of the Common Stock of the Abercrombie and Fitch Company of a par value of $1. per share	15,750.
	Cash of $15.08 per share	45,240.
	Total Fair Market Value	$349,740.

Abercrombie and Fitch Company had net earnings after taxes during the taxable year ended January 31, 1937 of $309,073.70.

The stock received by the executor of Bedford in exchange for his former holdings was not subject to taxation because it was received through a reorganization and under the provisions of Section 112 (b) (3) of the Revenue Act:

> "No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization."

There concededly was a recognizable gain to the recipient to the extent of the cash distribution of $45,240 in so far

as this cash and the securities received together exceeded the fair value of the shares the decedent held at the time of his death. This is so because of the provisions of Section 112 (c) (1) that in the case of money so distributed "gain * * * to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property."

It appears from the facts we have stated that the value of the stock Bedford held at the time of his death was $210,000 and the fair value of the securities and cash received through the reorganization was $349,740. Accordingly the gain amounted to $139,740 and the $45,240 of cash was taxable as a part of such gain if Section 112 (b) (3) should be applied. This, as we understand it, all parties concede. But the Commissioner held and successfully contended before the Tax Court that the cash distribution in pursuance of the plan of reorganization had "the effect of a distribution of a taxable dividend" and, therefore, subdivision 2 of Section 112 (c) (2), and not 112 (c) (1), applied. Section 112 (c) (2) provides that where such a distribution "has the effect of the distribution of a taxable dividend there shall be taxed as a dividend to each distributee such an amount of the gain recognized under paragraph (1) as is not in excess on his ratable share of the undistributed earnings and profits of the corporation cumulated after February 28, 1913. The remainder, if any, of the gain recognized under paragraph (1) shall be taxed as a gain from the exchange of property."

We held in *Commissioner vs. Quackenbos*, 78 F. (2d) 156; *Patty vs. Helvering*, 98 F. (2d) 717, and *DeNobili Cigar Company vs. Commissioner, decided June 20, 1944*, that when earnings are once capitalized by the issue of stock dividends they are no longer earnings but capital, except in cases where the purpose of the transaction is not

an honest business purpose but one to avoid taxation. Under those decisions the distribution here was a liquidating dividend and not an ordinary dividend. The slight verbal changes in the provisions of Section 112 (c) (2) and Section 115 (g) seem to us the equivalent of provisions of prior Revenue Acts. We think our decisions are reasonable interpretations of the purpose of the statute and see no just ground for distinguishing between capital raised by the issue of stock dividends and that obtained through subscriptions pro tanto by the shareholders. Here the purpose of the issue of the stock dividends was to add to the capital and the object of the later reduction of the capital stock through the reorganization was to enable the company to resume the payment of dividends when under the state law they could not be paid because the deficit had wiped out the surplus.

But even if the distributions here, according to the theory of the Commissioner and the Tax Court, might have been taken out of accumulated earnings, these distributions should have been charged to capital rather than surplus. In *Foster vs. United States*, 303 U. S. 118, the Supreme Court held that where a corporation had made distributions in redemption of part of its stock they were to be considered distributions in partial liquidation chargeable to capital account and not distributions of surplus. See also *Hellmich vs. Hellman*, 276 U. S. 233, 237.

The distribution here was a "partial liquidation" because all of the old stock of a par value of $300,000 was surrendered by the decedent for new stock having a par value of only $264,000. The transaction was evidently a distribution by Abercrombie and Fitch Company "in complete cancellation or redemption of a part of its stock." Such a distribution is a partial distribution as defined in Section 115(i) of the Revenue Act. *Hammans vs. Commissioner*, 121 F. (2d) 4, 7.

The order of the Tax Court is reversed.

RESPONDENT'S

BRIEF

No. 191

In the Supreme Court of the United States

OCTOBER TERM, 1944

JOHN K. BERETTA, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE [illegible] CIRCUIT

MEMORANDUM FOR THE RESPONDENT

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JOHN K. BERETTA, PETITIONER

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ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT

The petitioner has filed a reply to the brief in opposition filed by the Government in this case, in which he asserts (pp. 12–15) a direct conflict with the case of *Estate of Edward T. Bedford* v. *Commissioner* (C. C. A. 2d), decided August 8, 1944 (1944 C. C. H., par. 9441).

The *Bedford Estate* case is in conflict with the decision below insofar as it holds that a stock dividend, which was nontaxable in the hands of the distributees, diminishes earnings and profits. But the petition for certiorari in this case has not raised any question as to the correctness of the decision of the court below that a nontaxable stock dividend does not reduce earnings and

profits. Consequently, the point on which the conflict exists is not involved in the petition for certiorari now before this Court.[1] In any event, the decision below is correct. It is in accord with Section 115 (h) of the Revenue Act of 1936, c. 690, 49 Stat. 1648 (Resp. Br. 16), whereas the *Bedford* decision, we submit, is contrary to Section 115 (h). The decision below is also in accord with the great weight of judicial and administrative authority. See *Van Norman Co.* v. *Welch*, 141 F. 2d 99 (C. C. A. 1st); *Walker* v. *Hopkins*, 12 F. 2d 262 (C. C. A. 5th), certiorari denied, 271 U. S. 687; *Nolde* v. *United States*, 64 C. Cls. 204, certiorari denied, 276 U. S. 634; *Horrmann* v. *Commissioner*, 34 B. T. A. 1178, 1182; *F. J. Young Corp.* v. *Commissioner*, 35 B. T. A. 860, 865, affirmed without decision of this point, 103 F. 2d 137 (C. C. A. 3d); *Century Electric Co.* v. *Commissioner*, 3 T. C. 297, pending on review (C. C. A. 8th); *Chapman Price Steel Co.* v. *Commissioner*, decided September 7, 1943 (1943 B. T. A. Memorandum Decisions, par. 43,411), pending on review (C. C. A. 7th); Treasury Regulations 94, Article 115–11. See also 1 Paul & Mertens, Law of Federal Income Taxation, pp. 356–357.[2]

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[1] In the matter of filing a petition for certiorari in the *Bedford Estate* case on the basis of this conflict and for other reasons is now under consideration by the Government.

[2] Contrary to this rule are cases decided by the Circuit Court of Appeals for the Second Circuit: *Commissioner* v. *Quackenbos*, 78 F. 2d 156; *Patty* v. *Helvering*, 98 F. 2d 717 (both decided under the Revenue Act of 1928, which did not

The *Bedford Estate* case, however is not in conflict with the decision below on the question presented to this Court in the petition for certiorari, namely, whether a reduction in par value of stock constitutes a complete cancellation or redemption of a part of such stock. In the *Bedford* case, old preferred stock was surrendered in a corporate recapitalization, which constituted a reorganization under Section 112 (g) of the Revenue Act of 1936, in exchange for a new class of preferred stock, common stock, and cash. Under Section 112 (c) (1) the gain was recognized on this exchange only to the extent of the cash distribution, and under Section 112 (c) (2) if the cash distribution had the effect of a taxable dividend, it was to be taxed as a dividend insofar as it represented the distributee's share of undistributed earnings accumulated after February 28, 1913. Although the Circuit Court of Appeals for the Second Circuit held that the cash distribution was one in partial liquidation of all the old preferred stock, we believe that the court erred in holding that for

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contain a provision similar to Section 115 (h)); and *De-Nobili Cigar Co.* v. *Commissioner*, 143 F. 2d 436. Also contrary is *Byron Sash & Door Co.* v. *United States* (W. D. Ky.) decided April 10, 1944 (1944 P-H, par. 62,537), pending on Government's petition for review (C. C. A. 6th).

It will be noted that some of the cases cited in the text above were decided under Revenue Acts which contained no provision analogous to Section 115 (h). See particularly *Walker* v. *Hopkins*, 12 F. 2d 262 (C. C. A. 5th), certiorari denied, 271 U. S. 687; and *Nolde* v. *United States*, 64 C. Cls. 204, certiorari denied, 276 U. S. 634.

that reason Section 112 (c) (2) did not apply. The distribution was made in connection with a statutory reorganization, tax-free except for the cash, and the provisions of Section 112 (c) (1) and (2) determined how the gain (to the extent of the cash) should be taxed irrespective of whether or not the distribution might otherwise come under the definition of a distribution in partial liquidation. Such liquidation was only a step in the reorganization and is submerged in the reorganization for tax purposes. See *Love* v. *Commissioner,* 113 F. 2d 236 (C. C. A. 3d). But in any event, that case did not involve merely a reduction in par value of stock, as does the case before the Court. On the contrary, the old class of preferred stock was entirely surrendered and new classes of stock were issued in its place.

CONCLUSION

The *Bedford Estate* case is not in conflict with the decision below on the holding involved in the petition for certiorari.

Respectfully submitted.

CHARLES FAHY,
Solicitor General.
SAMUEL O. CLARK, JR.,
Assistant Attorney General.
SEWALL KEY,
HELEN R. CARLOSS,
HELEN GOODNER,
Special Assistants to the Attorney General.

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